

Franklin Intermediate High Yield Municipal SMA

Commentary | as of December 31, 2025

Key Takeaways

- **Markets:** In the fourth quarter of 2025 (Q4) new issuance of municipal (muni) bonds increased 14% year-over-year compared to 2024, culminating in a new annual record with tax-exempt issuance surpassing \$500 billion. By quarter end, the yield on the benchmark 10-year UST note moved two basis points (bps) higher to 4.17%, and the yield on the 30-year UST bond increased by 11 bps to 4.84%. The mid-November resolution of the US federal government shutdown supported sentiment through year-end. The Fed policy also drove overall returns, with three consecutive 25-bps rate cuts which were well received by the market. However, the future path of cuts grew ambiguous as Fed members were split on the need for further adjustments.
- **Contributors:** Overweight muni bonds with no external credit rating. Underweight bonds with longer maturities.
- **Detractors:** Overweight revenue-related muni bonds.
- **Outlook:** Municipal bond valuations continue to appear attractive, particularly on a tax-adjusted basis. In a more challenging environment, strong bottom-up research and disciplined security selection will be essential to identifying relative value and preserving portfolio quality.

Performance Review

- Our overweight to bonds that do not have external credit rating contributed to relative returns as these issues generally performed better than other rated bonds during the quarter.
- Sector exposure detracted from relative results. We focus on revenue-related bonds, including pre-paid gas structured bonds and muni bond real estate issues from land development and housing projects, which performed below general obligation muni bonds during the quarter.
- Duration positioning curbed performance. Our underweight to bonds on the longer end of the muni yield curve detracted from returns as yields fell on that segment of the curve.

Outlook

- While Q4 muni bond issuance exceeded historical averages, the pace of issuance slowed going into year-end, nonetheless full-year issuance exceeded last year's already elevated levels. Looking ahead to 2026, demand will play a crucial role as supply is projected to reach exceptional highs, primarily driven by infrastructure capital requirements that can no longer depend on previous government stimulus programs alone. This provides a stronger technical backdrop as demand has also increased over the past several months. The muni-bond yield curve remained relatively stable during the quarter.
- Fundamentals remain stable; however, slower economic growth will limit expansion in revenues across many sectors, in particular tax revenues. Rainy day funds remain healthy at the state and local government levels, which bolster fiscal resilience despite ongoing expense growth.
- Municipal bond valuations continue to appear attractive, particularly on a tax-adjusted basis. Yields remain above five-year averages, allowing investors to lock in compelling income. In a more challenging environment, strong bottom-up research and disciplined security selection will be essential to identifying relative value and preserving portfolio quality.

Average annual total returns (%) - as of December 31, 2025

Composite	3-Mo*	6-Mo*	YTD*	1-Yr	3-Yr	5-Yr	10-Yr	15-Yr	20-Yr	25-Yr	Inception	Inception Date
Net of Fees	1.33	3.93	3.44	3.44	4.10	—	—	—	—	—	3.72	11/30/2022
Pure Gross of Fees	1.70	4.70	4.99	4.99	5.66	—	—	—	—	—	5.27	11/30/2022
Benchmark	1.56	4.61	4.25	4.25	3.88	—	—	—	—	—	3.87	—

*Cumulative total returns

Benchmark(s)

Benchmark =Bloomberg Municipal Bond Index

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Glossary

A **basis point (bp, or bps)** is one one-hundredth of one percent (1/100% or 0.01%).

Duration is a measure of the sensitivity of a bond's price to changes in interest rates.

The **yield curve** shows the relationship between yields and maturity dates for a similar class of bonds.

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The **Bloomberg Municipal Bond Index** is a broad measure of the municipal bond market with maturities of at least one year.

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Source: Bloomberg Indices.

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